



June 8, 2004

Honorable Mayor and City Council:

The Scottsdale City Budget for the 2004/05 fiscal year is balanced, as required by Arizona state law, and keeps Scottsdale fiscally sound following the most challenging economic period in the City's history.

The adopted budget includes new revenues resulting from voter approval of the May 18 ballot initiatives to increase the City's sales tax rate, dedicating .10 percent to public safety and providing an additional .15 percent for the McDowell Sonoran Preserve.

Because of the new public safety revenue, the adopted operating budget includes approximately \$4.2 million to address high priority public safety needs such as traffic enforcement, code enforcement, additional police officers for the southern area encompassed by District 1, computer crimes investigations, upgrades to the police records system, enhancements to the crime laboratory, increased security at public buildings, upgrades to the photo radar program and formation of a park and preserve police patrol unit.

Because of the approval of the preserve tax, the adopted capital budget includes \$50.0 million for the McDowell Sonoran Preserve.

The total budgeted appropriation of \$1.1 billion continues to fund essential services, maintains investment in critical capital projects, carries forward Scottsdale's emergency reserve fund, and reflects a more realistic and better-defined Capital Improvement Program.

The adopted FY 2004/05 budget carries forward the March budget proposal with some modifications, based on public input and City Council directives. The City was able to channel \$12.2 million of the projected \$16.2 million ending FY 2003/04 General Fund unreserved fund balance towards the following in FY 2004/05:

- \$2.0 million for neighborhood revitalization in the area south of Camelback Road
- \$8.0 million set aside for investments in projects that will strengthen Scottsdale's economy
- \$2.0 million added to the General Fund contingency for capital projects
- \$0.2 million to replace the Police Mounted Patrol Barn at WestWorld, in place of a previous proposal to refurbish the existing barn

Other significant operating budget changes are:

- **Elimination of youth sports fields and aquatics facilities fees.** The budget eliminates the current \$3 per hour youth sports field maintenance fee and adds funding for maintenance of four additional youth sports fields. The related \$5 per hour aquatics facilities maintenance fee for City-sponsored aquatics teams will also be eliminated.
- **Papago Salado Association Membership.** The budget adds \$25,000 to the Mayor and City Council budget for membership in the Papago Salado Association.

The end of this budget process marks the beginning of the next. During the next 12 months, staff will track the national, state and local economies, report any new trends to the City Council and plan for them in the development of the proposed budget for FY 2005/06. The City's responsiveness to emerging economic challenges and its careful long-range planning have been key factors in Scottsdale's fiscal health.

The strength of the City's financial management was recently reaffirmed by the three major bond-rating agencies. All three continued their highest possible ratings for the City's general obligation bonds. This is a distinction the City earned in 2001 and continues to hold, along with a handful of exceptional local governments across the nation. This fact is especially noteworthy because many communities across the country have tapped into their financial reserves as revenues dropped, and their ratings have been downgraded. It is important to note Scottsdale did not use its General Fund Reserve in FY 2003/04 and has not assumed any use of the reserve to balance the FY 2004/05 budget.

The adopted budget is the culmination of the diligent efforts of many people. Special recognition goes to the Financial Services staff for their outstanding management of the City finances and the budget development process. The general managers and the City staff members who participated in the planning and execution of our expanded public outreach on the budget also deserve a sincere "thank you" for their time and assistance with this well-received effort.

The City Council Budget Subcommittee deserves acknowledgment for the many hours they dedicated to gathering citizen input and priorities on the proposed budget, their intensive review of the program and capital budgets, and guidance of staff. The subcommittee's public outreach efforts contributed to increased citizen involvement in the budget process.

Finally, a note of thanks goes to the Mayor and City Council for their leadership on many critical budget issues and for the time they devoted the budget process.

The economic turbulence of the past several years has highlighted the importance of Scottsdale's continuing efforts to keep the city's finances healthy and build a sustainable local economy. The staff looks forward to continuing this work with the City Council and the entire community in the coming year.



Janet M. Dolan
City Manager



March 9, 2004

Honorable Mayor and City Council:

The City of Scottsdale 2004/05 Proposed Budget reflects the early stages of an apparent recovery in the national, statewide and local economy after an unprecedented three years of declining revenues for the City. The budget is based on more optimistic economic forecasts than the City has seen since FY 2000/01. However, the optimism is guarded. The magnitude and timing of the economic recovery is uncertain. The City is past a historic period of expansion. Its economy is maturing and moving to a slower – and more sustainable – level of growth.

The projected modest improvements in the City's revenues and savings carried over from this fiscal year will allow Scottsdale to meet its most pressing needs for the 2004/05 fiscal year. These needs include the transition to a municipal fire department, an increased focus on code enforcement and property maintenance in the mature portions of the City, and continued emphasis on economic vitality and redevelopment. However, because of conservative revenue projections, longer-term forecasts show the City's needs will potentially outpace revenues in two years. Given the unsettled nature of the economy, it is difficult to project revenues two or more years into the future with a degree of certainty. The forecasts serve as an early warning that the city must continue to exercise restraint in its long-range fiscal planning.

For these reasons, the City staff is proposing a conservative balanced budget that includes a limited number of new positions for the City's highest priorities and incremental enhancements in services. City staff continued to use a zero-based, "program budget" approach, which focuses on the quality of each service citizens receive from the City, whether the service is provided by one department or several. The staff also continued to develop a more realistic and precise plan for continued investment in the City's basic infrastructure and public facilities, combined with a more comprehensive analysis of maintenance and operating costs.

As in years past, the main focus of the proposed budget is the General Fund, the City's largest fund, which supports basic services. Under the proposed budget, General Fund expenditures, debt payments and transfers-out to other funds will increase from \$194.9 million in the current fiscal year to \$214.1 million. The largest single factor in the increase is the transition to a municipal fire department, including one-time capital costs for new equipment. From a historic perspective, while General Fund expenditures, debt payments and transfers-out are increasing over last year, they remain below the \$218.2 million budget adopted in 2001/02.

Highlights of the proposed General Fund budget include the following:

Additional staff positions and resources to support the transition to a municipal fire department and to open a new fire station. The proposed budget includes \$5.8 million for equipment and other capital costs associated with the planned transition to a municipal department by July 2005. It also includes 13.5 new positions in other departments, such as Fleet Management and Human Resources, which will be phased in throughout the year to support the transition to a new municipal department. The estimated cost of the support positions is about \$520,000. The City's ongoing costs for these positions will be partially offset next fiscal year, when the City no longer is continuing to pay for the Rural/Metro contract. The proposed budget also includes additional firefighter positions to staff a new station at Jomax and Scottsdale roads.

A handful of new staff positions to address high priority service areas such as code enforcement, downtown, parks and recreation, economic vitality and building security. The budget proposes adding the equivalent of 8.84 positions at an estimated cost of \$440,000. These are the first new staff positions (unrelated to the fire transition) added to the General Fund budget since the FY 2002/03 budget. They include two code enforcement positions, two added positions in Economic Vitality focusing on job-creation, revenue enhancement and economic research, an administrative support position for the new Downtown Group, an additional technician for building maintenance needs, a position in the mailroom to help with increased security and screening, an added "K-9" police officer to enhance building security, and added part-time after-school recreation program leaders.

A \$3.5 million contingency for increased public safety services if voters approve a May 18 ballot measure. The draft General Fund budget includes this contingency so that the City will have the budgetary authority to spend additional dollars in FY 2004/05 if voters pass a ballot initiative to increase the City's sales tax rate by 0.10 percent for increased public safety services. The contingency would be used for additional police officers, code enforcement officers and upgrades in fire services.

A 2.5 percent cost-of-living pay adjustment for City personnel. Employees have not received a cost-of-living adjustment since January of 2003, and many are paying higher costs for health care and higher retirement system deductions. The total cost for the adjustment is \$2.7 million.

Added funding for public safety retirement costs. The City's contribution to the Arizona Public Safety Retirement System for FY 2004/05 increases by about \$600,000.

Added resources for tourism marketing. The draft budget includes a change recommended by the Tourism Development Commission to raise the percentage of Transient Occupancy Tax, or "bed tax," revenues that directly support tourism marketing and development. The proportion would rise from the current 66.7 percent to 80 percent. The change will provide approximately \$900,000 of additional funding for the City's hospitality development activities, but would eliminate the General Fund contribution for the Culture Quest program, which is funded at \$770,000 for the current fiscal year. Instead, Culture Quest and any additional tourism marketing initiatives would be funded through bed tax revenue.

Added support for downtown maintenance. The draft budget also reflects Scottsdale's effort to continue fostering economic vitality in the downtown area. It includes approximately \$465,000 for an Enhanced Maintenance Services Pilot Program to provide a higher level of maintenance, especially litter and refuse pick-up, for the downtown area.

Adjustments to youth sports field fees. The proposed budget proposes a reduction from \$3 to \$2 in the hourly fee charged to teams for the use of youth sports fields. The budget also provides an increased level of maintenance on four additional youth sports fields at Scottsdale schools.

Maintenance of the "emergency fund." The proposed budget continues the practice of setting aside a reserve equal to 10 percent of the General Fund and Highway User Fund program budgets to ensure the City can provide basic services in the event of major emergencies. This reserve is also very important in retaining the City's triple AAA bond ratings.

A second, significant component of the proposed budget is the Capital Improvement Budget, which includes funding for public buildings, parks, streets and other major infrastructure projects. The FY 2004/05 capital budget includes funding for:

- Reinvestment in infrastructure and parking structures in the downtown area.
- The new Fire Station #826 at Jomax and Scottsdale Roads
- A new Police Operational Building
- The CAP Basin Lighted Sports Complex
- The new senior center at the McDowell Village site at Granite Reef and McDowell roads
- The extension of Hayden Road north from Loop 101 to Thompson Peak Parkway
- The new Chaparral Water Treatment Plant
- Arsenic mitigation equipment for the City's water system
- Design of a proposed multi-purpose building at WestWorld

The proposed budget would affect citizens and taxpayers in the following ways:

The property tax rate will continue to drop. For the seventh consecutive year, the City's estimated combined property tax rate will drop. For FY 2004/05 the combined property tax rate will decrease by 5 cents from \$1.12 to \$1.07 per \$100 of assessed valuation.

Utility charges will rise marginally. The average homeowner's combined bill for water, sewer, refuse, and recycling services will increase an average of about \$1.50 per month.

A proposed charge may be added to utility bills for unfunded federal mandates on stormwater quality, if approved by the Council. The charge would increase the average residential utility bill by approximately 40 cents per month, in addition to the increase in regular charges. Revenue from this charge, approximately \$600,000 per year, will reimburse the General Fund for City programs needed to meet federal water quality standards for stormwater management.

Budget timing, ballot measures and state legislation

As noted above, the draft General Fund budget includes an appropriation of \$3.5 million for additional public safety expenditures, contingent on voter approval of a May 18 ballot measure for a dedicated 0.10 percent sales tax for public safety. The draft budget also includes capital appropriations for additional land purchases in the McDowell Sonoran Preserve if voters approve an additional 0.15 percent dedicated sales tax for preservation. The appropriations are included to give the Council flexibility to adjust the budget if voters approve these measures.

The City needs to include the additional appropriations to comply with state requirements for adoption of the tentative budget. The tentative budget sets the City's annual maximum legal expenditure limit. It cannot be increased after it is set in May. In the event the ballot initiatives are not approved, the City Council may lower the appropriation amounts when it adopts the final budget in June.

This proposed budget does not account for any potential legislative changes or modifications to the allocation of the state-shared revenues that could affect the City's final budget. The staff will continue to monitor the state's budget proposals and assess the impact of any proposed changes on the City.

Components of the Proposed Budget

This transmittal letter is intended to provide the City Council with a broad overview of the proposed budget, key changes and issues and recommendations for changes in the City's Financial Policies. As noted above, it focuses mainly on the General Fund. This fund provides the core services available to all citizens, and therefore warrants the most attention during the budget review process.

Two additional volumes complete the proposed budget. Volume Two includes individual budgets for more than 180 programs. The goal of the program budget is to provide the City Council, citizens, and other stakeholders a more focused analysis of the costs of each City service or function, whether the service is provided by one department or through the combined efforts of several areas. Each program budget includes a program description, services provided, City Council Broad Goals supported by the program, a multi-year summary of budget and staffing, customers, program broad goals and objectives and performance measures.

Volume Three provides a detailed summary of the proposed FY 2004/05 capital budget and five-year capital improvement plan, or CIP.

The following is a summary of budget highlights by fund. A more detailed analysis of each fund – revenues and operating expenditures – is included in the "Budget by Fund" section of this volume.

General Fund Revenues

The General Fund supports core services and is the largest fund with the greatest potential for revenue fluctuations. General Fund revenue estimates in the proposed budget are pragmatic. In the aftermath of three years of an economic downturn, with consumer confidence improving, the staff could risk being overly optimistic in forecasting revenues, hoping for more rapid revenue growth to better address the "pent-up" needs of the community. This approach would not be in the best long-term fiscal interest of the City.

The revenues forecasted in this proposed budget reflect a guarded optimism, tempered by the reality that the local, state and national economies are complex and uncertain. The proposed budget is based on projections that

LETTER DATED MARCH 9, 2004 *City Manager's Budget Transmittal*

Scottsdale's population will continue to grow at an annual rate of 1.6 percent, and the City will experience an estimated annual inflation rate of 2.5 percent for the coming fiscal year.

Total General Fund revenues and transfers-in are expected to increase about 5.2 percent, from \$203.7 million in FY 2003/04 to \$214.2 million in FY 2004/05. The following General Fund revenues represent the most significant changes between fiscal years:

Transaction Privilege Tax, or "Sales Tax" – These revenues are drawn from the 1.0 percent General Fund share of the City's 1.4 percent sales tax. (The remaining 0.4 percent goes to Special Revenue Funds for transportation and the McDowell Sonoran Preserve.) The tax is the City's single largest revenue source. It is projected to increase 3.2 percent, or \$2.6 million, to \$84.8 million in FY 2004/05. The projected increase in the tax reverses a three-year decline in sales tax revenue. The tentative nature of the national, state and local economies, relatively high unemployment and slow job growth, and the ongoing threat of terrorism all have the potential to affect this elastic revenue source. Beyond FY 2004/05, the five-year financial plan projections reflect a slow and modest increase in sales taxes – essentially keeping pace with a projected modest inflation rate.

Property Taxes – This revenue source is one of the few stable General Fund revenues and is anticipated to increase by \$1.1 million, or 6.4 percent over FY 2003/04, to \$17.6 million. The increase in revenue is driven by a combination of growth in existing property assessment values, up 6.2 percent, and new construction, up 4.6 percent.

Transient Occupancy Tax, the Hotel "Bed Tax" – This revenue source is expected to increase to \$6.7 million, a very modest 2 percent increase from FY 2003/04. Like sales taxes, these revenues are less predictable because of ongoing uncertainty in the economy and the magnified effects of potential acts of terrorism on business and pleasure travel. Growing competition from new resorts in neighboring jurisdictions limits the likelihood of significant growth in this revenue source in FY 2004/05 and beyond.

State-Shared Revenues, or "Intergovernmental Revenues" – These revenues are projected to increase less than 1 percent, from \$34.2 million in FY 2003/04 to \$34.5 million in 2004/05. These revenues are from state sales and income taxes shared with Arizona cities and towns, based on a statutorily determined formula. The shared sales tax revenue projection is based on a slow and modest statewide economic recovery. The shared income tax revenue projection reflects a two-year lag between the time citizens file their state taxes and the date the revenues are sent to cities and towns. These estimates do not factor in any potential reductions resulting from legislative changes or reductions. The Five-Year Financial Plan assumes the mid-decade census will adversely impact the City's state-shared revenues by an estimated \$1.7 million in FY 2006/07, as faster growth cities and towns within the state receive an increased proportion of the overall pool of state-shared revenues.

Development Permits and Fees - These revenues are projected to decrease by \$750,000, or 5 percent, to \$14.3 million from FY 2003/04. This unpredictable revenue source can have dramatic peaks and valleys from year to year. The staff foresees a slight slowdown in development and construction during the coming fiscal year and beyond as Scottsdale approaches build-out.

Fines and Forfeitures – These revenues are anticipated to increase approximately \$800,000, or 18.2 percent, to \$5.2 million in FY 2004/05. These revenues are expected to rise significantly because the State Legislature repealed legislation that diverted a substantial portion of the City's court fine revenue to the state.

Transfers-In – As noted above, the proposed budget includes a \$3.5 million contingency if voters approve a 0.10 percent sales tax for public safety. Those dollars would be transferred into the General Fund to support police, fire and code enforcement. This transfer-in constitutes a significant portion of the increase in General Fund revenues for 2004/05.

General Fund Expenditures

Under the proposed budget, General Fund expenditures, debt payments and transfers-out of the fund increase \$19.2 million, or 9.9 percent, from \$194.9 million in FY 2003/04 to \$214.1 million in FY 2004/05. The most noteworthy changes in the General Fund expenditures and transfers-out are outlined below:

New Staff Positions – The proposed budget includes the payroll, benefits and operating costs associated with 22.34 new General Fund positions, for a total cost of about \$960,000. The new staffing includes 13.5 new positions to support the fire transition, at a cost of about \$520,000. Most of these positions will be filled in the second half of the fiscal year to minimize the budget impact. The remaining 8.84 new positions add about \$440,000 to the proposed

budget and will be filled in the first half of the fiscal year. These new positions will address high priority services areas such as code enforcement, downtown, trash collection, parks and recreation, economic development and increased security for City buildings.

Contract Worker Conversions – The proposed budget reflects the conversion of 2 full-time and 10 part-time contract worker positions to City employee status. These long-time contract positions are in ongoing high priority service areas such as maintenance and citizen security. The conversions to City employee status will contribute to the Council's goal of high quality core services. The conversions are the equivalent of 6.2 full-time positions. After eliminating the contractual service costs for these individuals, the net fiscal impact on the FY 2004/05 budget is less than \$6,800.

Public Safety Retirement Costs – The City's contribution to the Arizona State Retirement System for police officers will rise by about \$600,000 in FY 2004/05. Under state law, a public safety employee's contribution to the retirement system is capped at 7.65 percent of the employee's annual compensation; the employer must pick up any increase in the actuarially determined total contribution rate.

Market Pay Adjustment – The proposed budget includes a 2.5 percent cost-of-living pay adjustment for City personnel, which equates to a \$2.7 million impact on the General Fund. The adjustment will help keep Scottsdale's pay ranges competitive. Employees have not received a cost-of-living adjustment since January 2003 and many have less take-home pay because of increased costs for retirement and health care.

Transfers-Out – The 2004/05 proposed budget increases the total amount transferred out of the General Fund to other funds by more than 50 percent, to \$16.9 million. The primary driver for the increase is a \$5.8 million transfer to the Capital Improvement Program for one-time capital equipment and facilities costs associated with the fire department transition. The transfer-out to the Highway User Revenue Fund (HURF) will increase by more than \$400,000, to \$3.6 million, to support transportation programs. Finally, \$600,000 is budgeted for transfer to the Self-Insurance Fund to meet the actuarially determined funding recommendations for claim expenses and rising insurance costs.

Fire Services - The fire budget includes \$1.3 million of contractual increases primarily for union-negotiated firefighter pay adjustments, anticipated increases in Rural/Metro Corporation's health care costs, and 401K benefits. It also includes \$300,000 for added firefighter positions for a new fire station at Jomax and Scottsdale roads. These positions are expected to be hired in the spring of 2004 and will work out of the temporary station at Jomax and Pima roads until the permanent Station #826 is completed.

Downtown Group and Downtown Maintenance – The Downtown Group, established in the second half of FY 2003/04, continues to strategically address the needs of downtown businesses, the arts community and a growing downtown residential population. This program has assumed the responsibility for managing the City's contract with the Scottsdale Cultural Council. Funding transfers from other programs offset most of the costs for this new program. The City also will launch a \$465,000 Enhanced Maintenance Services Pilot Program in the downtown, covering an area of more than 700 acres. The pilot program, mainly for enhanced litter and refuse services, is included in the Community Services Department budget. Most of the funding for this new pilot program will come from a Solid Waste Fund transfer-in.

Culture and Tourism – The proposed budget includes a 3 percent increase for the Scottsdale Cultural Council contract and a 2 percent increase for the Scottsdale Convention and Visitors Bureau contract. Also proposed is a modification in the percentage allocation of the bed tax, which would increase the City's budget for tourism development. Additional information on the proposed modification to the bed tax is under the section on "General Fund Policy Options for Council Consideration" below.

General Fund Balances and Reserves

The proposed FY 2004/05 budget includes the following fund balances and reserves:

General Fund Reserve – This reserve, projected to total \$24.2 million at the end of 2004/05, continues the City's financial policy of setting aside funds to protect Scottsdale in times of emergency. This is the City's "savings account." Most of these funds are carried over from previous years, and once they are spent, it will be extremely difficult to rebuild the reserve. It is financially prudent to have a minimum General Fund Reserve of \$22.2 million, an amount equal to 10 percent of total annual operating costs for the General and Highway User Revenue funds. For FY 2004/05 the proposed General Fund Reserve includes an additional \$2 million set aside in case the City must

pay a settlement in an ongoing taxpayer refund audit. Maintaining this reserve is very important to the municipal credit rating agencies and in retaining the City's triple AAA bond ratings.

Economic Investment – The proposed budget uses a portion of the original \$5.0 million balance set aside by the City Council for strategic economic development investments that demonstrate clear returns to the community. In FY 2004/05, \$304,000 from the Economic Investment allocation is proposed to pay a share of the initial debt payments for the Loloma Museum. Bed tax revenues will cover the balance of the debt payments, \$223,000. During FY 2004/05, the staff anticipates the Economic Investment allocation will provide \$500,000 of the \$3 million loan, approved by City Council last December, for the new Mayo Clinic/TGen research facility.

Operating Contingency – The proposed budget includes a \$2.5 million operating contingency to meet unforeseen expenses during the year. This reserve is especially important in FY 2004/05, as we prepare for the transition to a municipal fire operation and possible unforeseen costs.

Open Purchase Order Reserve – The proposed budget anticipates \$4.4 million of purchase orders from FY 2003/04 that will be completed and paid after the June 30 fiscal year-end. This reserve provides a funding source for these year-end carryover items.

Unreserved Fund Balance – After considering all of the other reserves, an unreserved fund balance of nearly \$12.6 million is projected at the end of the 2004/05 fiscal year, resulting mainly from a large carryover from the 2003/04 budget. These funds are not designated for a specific purpose. The City Council may choose to allocate some or all of these dollars for new or expanded programs or requests, or to allocate them to other reserve funds. The unreserved fund balance represents an accumulation of one-time revenues and would most appropriately be used for one-time expenditures, not to fund new or expanded programs with ongoing operating costs.

General Fund Budget Options for City Council Consideration

The General Fund budget outlined above is based on changes in three key Financial Policies recommended by the City staff for Council consideration. The changes would apply to:

The allocation of bed tax revenue. The Tourism Development Commission is recommending that the City Council increase the percentage of bed tax revenues used for tourism development purposes from 66.7 percent to 80 percent. The recommendations would require amendments to a City Ordinance. The change would mean a smaller portion of bed tax revenues, 20 percent, would remain in the General Fund to support core City services, and a larger portion would go to tourism development. As an offset, however, the current \$770,000 annual contribution from the General Fund for the Culture Quest program would be eliminated. Tourism development uses include destination marketing and promotion provided through the Scottsdale Convention and Visitors Bureau contract, visitor research and visitor-related capital projects.

The use of construction sales tax revenues. The staff is recommending a financial policy that limits to 75 percent the portion of annual construction sales tax revenues that may be used for ongoing operating expenses. The remaining 25 percent would be used to fund projects in the City's Capital Improvement Plan. This policy is intended to prevent an over-reliance on the potentially volatile construction sales tax for year-to-year operating costs.

Water quality charges. The staff is recommending that the City Council include a charge in water bills to fund programs to meet unfunded federal storm water quality mandates. The charge would help the City meet requirements under the National Pollution Discharge Elimination System (NPDES). The charge would generate approximately \$600,000 annually.

Special Revenue Funds

The City accounts for revenues earmarked for specific purposes – by law or City policy – through special revenue funds. Two potential new funds are included, one funded by the 0.15 percent sales tax increase for McDowell Sonoran Preservation proposed on the May 18 ballot, and the second funded by the 0.10 percent sales tax increase for public safety proposed on the same ballot. As noted previously, the potential new revenues and expenditures associated with these funds are included in the proposed budget to allow the City to comply with the Arizona's tentative budget adoption requirements.

The largest existing special revenue funds, by far, are for transportation and preservation. Transportation programs are accounted for in two separate funds, the Highway User Revenue Fund and the Transportation Privilege Tax Fund. The

Highway User Revenue Fund accounts for transportation operating expenditures. These include \$10.3 million for master planning, transit services, traffic engineering and other operations in the Transportation Department and \$11.5 million for street and signal operations and maintenance provided by the Municipal Services Department.

The revenues and transfers-in to the Highway User Revenue Fund are expected to increase 4.8 percent, from \$23.8 million in FY 2003/04 to \$24.9 million in FY 2004/05. The largest source of revenue for this fund is the state Highway User Revenue Fund tax, commonly known as the gas tax. State shared gas taxes are expected to increase by about 3 percent from \$13.5 million to \$13.9 million. Local Transportation Assistance Fund revenue from the Arizona State Lottery is expected to remain at the same level as 2003/04, about \$1.1 million. Transfers-in to the fund are projected to increase by almost \$800,000 from \$9.1 million to \$9.9 million.

Total revenue to the Transportation Privilege Tax Fund is expected to increase 3.2 percent from \$15.2 million in FY 2003/04 to \$15.7 million in FY 2004/05. All of the revenues in this fund are used to support transportation purposes. Approximately \$6.3 million will go to the Highway User Revenue Fund to pay for operating costs supporting transportation improvements and \$9.4 million will go to the Capital Improvement Plan for transportation related capital projects.

Total revenue to the 1996 Preservation Privilege Tax Fund, which draws its revenue from the existing 0.2 percent preservation sales tax, is expected to increase by 3.2 percent from \$16.3 million in FY 2003/04 to \$16.8 million in FY 2004/05. Total expenditures and transfers-out of the fund are estimated at nearly \$21.0 million, compared to \$17.0 million in the current fiscal year. The primary expenditure driver is an anticipated increase in debt payments related to the planned issuance in April 2004 of \$65.4 million of General Obligation Preserve Bonds. The bonds will provide funding for the City to move ahead on current preserve purchase plans.

The budget for the 2004 Preservation Privilege Tax Fund, supported by a proposed 0.15 percent increase in the sales tax rate for preservation, is *contingent* on the outcome of the May 18 ballot initiative. The first-year revenue forecast for this potential new fund is \$11.7 million. Under the ballot language, revenues received by this fund may be used for debt service payments related to preserve acquisition and preserve-related construction, such as proposed trailheads.

The budget for a new Public Safety Privilege Tax Fund also is *contingent* on the outcome of another May 18 ballot question. The first-year revenue forecast for this potential new fund is approximately \$7.9 million. The total transfers-out of this fund to the General Fund for the purpose of covering proposed public safety initiative costs are estimated to be \$3.5 million. Any revenues collected and not transferred in FY 2004/05 would remain in the fund exclusively for future public safety uses.

A collection of smaller restricted revenues for specific City services is included in the Special Programs Fund. The services included in these various funds are intended to be fully self-supporting and not subsidized by the General Fund. Total revenues and transfers-in and expenditures and transfers-out for these funds are estimated at \$2.5 million and \$4.0 million, respectively.

Examples of these funds include the Police Department RICO funds, the City Court's Court Enhancement Fund, the McCormick-Stillman Railroad Park Fund, the Scottsdale Cares charitable fund and the Preservation Rehab Fund for historic building rehabilitation.

Enterprise Funds

Enterprise funds account for the City's water, sewer, solid waste collection and aviation services, operated as stand-alone businesses. User fees are assessed to cover the full cost of services. Under the proposed budget, the total for revenues and transfers-in to these funds increase from the \$124.6 million in FY 2003/04 to \$130.9 million in FY 2004/05.

Federal water quality mandates continue to significantly affect the Water and Sewer Fund. The City faces mandates to reduce arsenic levels in drinking water and another forthcoming mandate to reduce levels of by-product compounds from chlorine disinfection by 2006. In this past year, the City began a trial project to help determine the most effective method to meet federal standards. However, the Five-Year Financial Plan still anticipates the need to issue over \$100 million in debt to pay for the infrastructure to meet these mandates.

The budget includes a modest 2.5 percent water fee increase to help pay for these added costs. It also includes future debt of \$20.0 million, to be issued in April 2004, and a small increase, 3.0 percent, in sewer rates to fund expansion and upgrades to wastewater treatment facilities.

The proposed fund balance and reserves in the Water and Sewer Fund will continue to meet three policy objectives adopted by the City Council last year: (1) ensure adequate funding for operations, (2) ensure infrastructure repair and replacement and (3) provide for incremental and affordable rate changes for customers over time. The long-range water and sewer financial plan focuses on preserving two reserves: a 90-day operating reserve and an infrastructure repair/replacement reserve (as required by our revenue bond indenture). Remaining accumulated funds will be used only for future infrastructure projects and to level rate impacts to customers over time. The budget proposes a drawdown of accumulated cash in accordance with the water and sewer multi-year financial plan to fund major infrastructure projects needed to meet the unfunded federal mandates for water quality previously noted.

The proposed FY 2004/05 Solid Waste Fund budget includes no increase in fees for the operation of refuse collection and recycling services. The Solid Waste Fund is expected to maintain a positive fund balance over the life of the Five-Year Financial Plan. The plan continues to meet the 90-day operating reserve financial policy adopted by City Council last year. The 90-day operating reserve was established to provide future funding to address emergencies and the possibility of significant future landfill cost increases. In 2004/05, it will help fund the new enhanced downtown maintenance pilot program.

Under the proposed budget, the average monthly residential utility bill for water, sewer and refuse service would increase about \$1.50 per month. As noted under the General Fund budget options section above, another 40 cents would be added to the average monthly residential bill to fund compliance with federal stormwater quality mandates.

The proposed FY 2004/05 Aviation Fund budget includes no increase in landing fees in FY 2004/05. The five-year forecast for this enterprise fund projects continued positive fund balances and no planned operating subsidies from the General Fund. The Aviation Five Year Financial Plan will meet the 90-day operating reserve financial policy adopted by City Council last year. This 90-day operating reserve was established to provide funding for potential emergencies, to provide matching funds for potential grants and to ensure that further General Fund subsidies are avoided.

Proposed Enterprise Funds policy changes for City Council consideration include the following:

The proposed water quality charge for stormwater. Details of this proposal are explained above under the section on "General Fund Budget Options." Revenues would be collected in the Water and Sewer Enterprise Fund and transferred-out monthly to the General Fund.

Funding for the Enhanced Maintenance Services Pilot Program. The proposed Solid Waste Fund budget includes approximately \$370,000 to fund the new Community Services Department pilot program in the downtown. The new program will provide residents and businesses located within the 700-acre downtown an enhanced level of litter and trash service to bolster the image and appearance of the area. An estimated 80 percent of the enhanced services would be solid waste-related. Therefore, the staff is recommending that the City Council authorize funding for up to 80 percent of the pilot program costs to come from the Solid Waste Fund, through a transfer-in to the General Fund.

Internal Service Funds

Internal Service Funds account for services and equipment provided to all City departments by centralized divisions, such as maintenance of the City's vehicle fleet and insurance coverage.

Most of the \$30.9 million in FY 2004/05 revenues and transfers-in to these two funds come from internal charges to City departments.

The total revenue and transfers-in to the Self-Insurance Fund of \$18.9 million reflect an expected increase over the current fiscal year, as the City moves to self-insuring for health care. The proposed budget anticipates total operating and claims expenditures and transfers-out of \$16.7 million in FY 2004/05. The projected ending fund balance reserve is \$12.1 million for property casualty and \$8.1 million for health benefits.

The proposed Fleet Management Fund forecasts \$12.0 million in revenues and includes a 3 percent increase in the FY 2004/05 fleet rate, which is then reflected in fleet rates charged to City departments. The FY 2004/05 budget includes \$3.6 million for vehicles and equipment. Of that amount, \$1.3 million would go to public safety vehicles and equipment, \$400,000 for solid waste, \$300,000 for street maintenance, and \$1.5 million for general fleet replacements. Additionally, the budget includes approximately \$59,000 to cover the initial costs associated with the staggered hiring of four equipment mechanics starting in March 2005 for the July 2005 fire department transition. After considering all of the proposed acquisitions and rates, the proposed Five-Year Financial Plan for the Fleet Management Fund continues to maintain a solid fund balance reserve.

Debt Service Fund

Debt service funds are designated for payment of long-term debt not directly paid through the General, Enterprise or Special Revenue funds.

Total revenues and transfers-in to these funds are estimated at \$49.6 million for FY 2004/05, compared to \$41.7 million for FY 2003/04. The same amount, \$49.6 million, is planned for debt service payments. The increase in debt service payments results from planned April 2004 debt issuances of \$48.0 million of General Obligation Bonds for capital projects in the Bond 2000 Program.

Property taxes levied to pay for voter-approved bonds are the largest revenue source, providing \$26.9 million in FY 2004/05. The proposed budget projects the rate for "secondary" property taxes, the portion of property taxes specifically dedicated for bonds, will drop 2 cents from 64 cents to 62 cents per \$100 valuation. This is the seventh consecutive year of a drop in the property tax rate.

Debt service funds also receive revenue from special district assessments and pay for special district debt service. The remaining revenues in these funds are from interest earnings and miscellaneous sources.

Capital Improvement Plan

A separate, key component of the annual financial plan is the City's Five-Year Capital Improvement Plan (CIP) for infrastructure and public facilities – including roads, water and sewer improvements, parks, buildings and information technology.

The City staff continues to use enhanced project evaluation and cash management processes started last year to prioritize and propose funding for projects. Prior budgets reflected very aggressive and sometimes unrealistic plans to move projects forward. The proposed five-year CIP uses updated, more conservative financial forecasts and reflects only those projects with the highest priority and most realistic expectation for completion during the next five years. This approach avoids raising expectations for projects that are not well defined or that the operating budget will not support. Projects not included in the new five-year CIP will be kept on a pending projects list to be incorporated in a later year when financial forecasts improve.

The improvements in managing CIP finances are helping the City hold down the amounts transferred from the General Fund for capital funding. Setting aside the \$5.8 million in one-time capital costs for the transition to a City fire department, transfers-in from the General Fund actually drop from \$6.8 million in FY 2003/04 to \$6.7 million. The underlying decrease is a result of the new capital project rejustification process undertaken this year and the ability to adjust capital cash flow requirements to better match actual capital spending.

The total proposed CIP appropriation for FY 2004/05 is \$730.3 million, which includes the following major project areas (in millions):

Community Facilities	\$134.2
Preservation	\$108.7
Neighborhood Drainage & Flood Control	\$22.5
Public Safety	\$51.2
Service Facilities	\$21.4
Transportation	\$139.3
Water Services	\$253.0

The City continues to face a quandary in capital funding plans. An extremely favorable bond market makes debt financing very attractive at this time. At the same time, the City has limited resources to fund operating costs for many of the proposed capital projects.

Scottsdale is only starting to see signs of an economic recovery after the worst recession in the City's history. The proposed five-year CIP attempts to continue – and even expedite – priority projects with minimal near-term operational impacts.

Also included in the proposed Capital Improvement Plan are administrative changes that will assist in better management of cash flows and project expenditure tracking. For example, where feasible, projects that formerly had

multiple funding sources – such as bonds and the 0.2 percent transportation sales tax – will move to a single funding source. This change will improve the management of cash flows for the various funding sources, resulting in better planning of bond issuances, federal arbitrage compliance, and citizen property tax impacts. Without this change, the allocation of expenditures to different funding sources is based on assumptions that do not always provide a reliable estimate of the amount and timing for future bond issuances.

One positive outcome of this approach for taxpayers is a plan that forecasts the combined property tax rate dropping from \$1.12 to \$1.07 per \$100 assessed value in FY 2004/05 and staying at or below \$1.07 for the next five years. This is 43 cents, or 29 percent, below the \$1.50 financial policy limit initiated with the Bond 2000 authorization.

Conclusion

The information provided in this proposal provides the basis for a comprehensive discussion of the proposed budget over the next few months, when the City Council and the public will have the opportunity to gain more insight into the budget development process and the City's financial picture.

The primary goals of this challenging budget development process have been to:

- Use conservative and realistic revenue forecasts.
- Limit staff increases to high priority service areas and redeploy existing staff, where possible.
- Use a zero-based program budget approach to justify and control expenditures while still focusing on achieving the City Council's Broad Goals and providing basic City services.
- Focus on continuing high priority programs and eliminate or reduce funding to less critical programs.
- Continue to fund needed investment in the City's infrastructure and facilities.
- Continue to plan for the future through the astute use of City resources for strategic economic development investments that demonstrate a clear return to the community.
- Maintain a prudent level of financial reserves.

It is appropriate to thank the City staff, especially Chief Financial Officer Craig Clifford, Budget Director Art Rullo and the entire Financial Services staff, who have put much time and expertise into the development of the proposed budget. The staff has been working on this document since adoption of the FY 2003/04 City Budget, when the first steps of this budget review process began. Departments have worked closely with the Financial Services staff and senior management in developing, documenting and reviewing every component of this proposal. The staff has embraced the City Council's Broad Goals in building a financial plan that delivers the highest quality services at the most reasonable cost to the residents and businesses of Scottsdale.

Citizens already have met with the members of the City Council Budget Subcommittee and the staff to discuss budget priorities for the coming year, and many of their insights have been incorporated in the proposed budget. Over the coming weeks, the subcommittee and citizens will devote many more hours to understand and analyze the proposed budget and offer their perspectives. Their input is an important part of the budget development process.

The City Council is scheduled to begin its formal review of the proposed budget on April 5, when the staff will present the proposed Capital Improvement Plan. Two weeks later, on April 20, the staff will present the proposed Operating Budget and Comprehensive Financial Policy updates. The City Council is scheduled to adopt a tentative budget on May 17 and final budget on June 8, 2004.

The City staff and I look forward to a thorough and thoughtful examination of the FY 2004/05 proposed budget.



Janet M. Dolan
City Manager